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¶1. (SBU) Summary. The Accelerated and Shared Growth Initiative (ASGI), a new government economic strategy to be unveiled in February, aims to push growth to a sustained six percent annually. It is expected to focus on improving coordination and implementation. Key elements will be infrastructure investment through state-owned enterprises, labor market reform, improved service delivery, skills development, a revamped industrial policy and small business support. Overall, ASGI's focus is reasonable and needed. The SAG can directly influence most of the key elements, but with the unions, the SACP and groups within the ANC opposed, labor reform is unlikely in the short-term. Still, successful implementation of the other ASGI initiatives could move South Africa's long term growth rate to a higher level. End Summary.

## Strategy for Higher Growth

¶2. (U) Over the last half of 2005, a SAG ministerial team led by Deputy President Phumzile Mlambo-Ngcuka has developed a new government economic strategy, the Accelerated and Shared Growth Initiative (ASGI). It focuses on microeconomic policies and replaces the Growth, Employment and Redistribution (GEAR) strategy that has been the basis for South Africa's macroeconomic stability. ASGI is designed to push economic growth to a sustained six percent annually, twice its ten-year average and the level commonly accepted as necessary to reduce the country's high unemployment, by 2010. Although widely commented on in the media, ASGI is still under review. A government ministerial retreat (lekgotla) in mid-January is expected to formally adopt the strategy, which will be unveiled in February in President Mbeki's State of the Nation address and Finance Minister Manuel's budget presentation.

¶3. (U) ASGI is not expected to include major policy

shifts but rather to focus on improving coordination and implementation. The strategy will include some new initiatives, such as to increase investment and hire and train workers, and incorporate policies already announced, such as an emphasis on state-owned enterprises (SOE's) to boost growth. Mlambo-Ngcuka recently emphasized to Parliament that the strategy will not be a "quick fix." It will take time to push investment to the target of 25 percent of GDP, as well as growth to over 6 percent.

¶4. (SBU) In developing ASGI, ministers in the cabinet's economic cluster identified six constraints to higher growth: currency volatility, infrastructure bottlenecks, the regulatory environment, service delivery, skills shortages and import-parity pricing. All of the constraints are well known and frequent subjects of debate. In practice the first and last are likely to receive limited attention in the new strategy. Rand stability has largely been achieved over the last three years (ref A). Government jawboning will be the major policy tool to address import-parity pricing, characteristic of relatively few industries; e.g., steel, plus high costs and poor service from Eskom and Telkom, respectively the electricity and telecommunications monopolies. A business ADSL line, for example, is 150 percent more expensive than the international average.

## Infrastructure

¶5. (SBU) Neglected for decades, upgrading and improving the efficiency of South Africa's infrastructure will be the cornerstone of ASGI. In



addition to high input costs from Eskom and Telkom, the deteriorating and capacity-limited roads, railroads and ports are a major constraint on growth, and particularly exports. Finance is not expected to be an issue. Several of the major SOE's can use retained earnings or borrow at reasonable rates, given South Africa's improved credit ratings. In addition, the SAG could fund as much as R370 billion ($58 billion) over three years for infrastructure development, much of which will go through public private partnerships. Public Enterprises Minister Alec Erwin believes that in addition to improving infrastructure, the policy will add employment, offer skills development and provide new technology. The emphasis on SOE's enjoys wide support, particularly from the trade unions, who see it, only partially correctly, as an abandonment of the SAG's drive to privatization (refs B and C).

## Labor Reform

¶6. (SBU) The "regulatory environment" constraint is often shorthand for labor market reform, although concern also exists about the regulation of the financial sector and general price collusion. Independent economists and organizations such as the World Bank and IMF have long argued that South Africa's relatively rigid labor market needs reform. In fact, the IMF estimates that the easing of labor market legislation would add 0.5 percent to the growth rate. Senior SAG officials, including Finance Minister Manuel and Reserve Bank Governor Mboweni, a former labor minister, have publicly urged more flexibility but so far to no avail. ASGI will take another run at labor market reform, but little progress is likely. At the ANC's National General Council meeting in mid-2005, COSATU, the leading trade union federation; the SA Communist Party; and

the ANC Youth League blocked debate on liberalization proposals which emphasized creation of a two-tier labor market that had been presented in a discussion document drafted by the Deputy Finance Minister. Many feel ASGI is unlikely to be different (refs D and E).

Service Delivery and Skills Development
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¶7. (SBU) Government's ability to improve municipal service delivery will be a central issue of the ASGI. While the ANC government has done an admirable job in providing housing, water and sanitation, electricity and other services to poor communities, it has not met expectations. On numerous occasions throughout 2005, residents of poor communities took to the streets to protest the lack of service delivery. President Mbeki acknowledged in last year's State of the Nation address that many South Africans are still waiting for public services, and the Finance Minister allocated additional resources in the budget, even though resources are not the key problem. For example, in FY 2004 provincial government failed to spend 17 percent of their capital budgets. In fact, the SAG conceded in Parliament that 136 of 284 municipalities are "underperforming." The underlying causes of municipal failure rest with a lack of staff and trained professionals. Ref F documents the many problems of service delivery in one municipality. If the ASGI is to succeed it must produce results in this area.

¶8. (SBU) Investment in education and skills development is also likely to be a major emphasis of ASGI and to receive special attention when Finance Manuel presents his new budget. For example, the minister may call for a recapitalization of education and training colleges with an emphasis on increasing math and science graduates. Manuel has been publicly critical of the education system for its failure to produced sufficient skilled individuals, such as artisans, engineers and IT specialists, which he views as a major constraint to higher growth. He has asserted that a focus on improving the high school



graduation exam (matric) pass rate has discouraged students from taking difficult subjects; i.e., math and science. Manuel has also criticized unions for blocking proposals to pay a premium to math and science teachers.

¶9. (SBU) To help address the skills gap in the short term, the SAG has quietly embarked on a program to encourage skilled South African expatriates to return and retirees to re-join the work force. Public Enterprises Minister Erwin pointed out in September that this initiative is already paying dividends in the electricity generation sector. The SAG has also said it would hire foreign labor when needed. During a visit to India, the Minister of Public Services and Administration raised the possibility of work in South Africa, particularly in the education sector.

Industrial Policy and Small Business Development
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¶10. (SBU) Although not identified as a constraint, ASGI is expected to include in some form a revamped industrial strategy. In practice, this will be the Department of Trade and Industry's (DTI) contribution, and it will likely feel compelled to propose a more active governmental intervention in promoting industrial and service industry

development. Although Manuel says the new policy will not be about picking winners but rather identifying obstacles and removing them, ASGI will likely contain policies to promote mineral beneficiation (e.g., diamonds), advanced manufacturing (e.g., aerospace), light manufacturing (perceived as labor intensive), and providing the outsourcing needs for foreign business services (e.g., call centers). The DTI planners will be trying to replicate the highly regarded Motor Industry Development Plan (MIDP) in other sectors, although some analyses suggest that the costs of MIDP outweigh its benefits.

¶11. (U) ASGI will also contain policy and program initiatives that give more attention to small and medium size business development. More government procurement will be directed toward small businesses (e.g., through the new Small Enterprise Development Agency), and the SAG's small and medium size business finance agencies (e.g., the Industrial Development Corporation, Khula Enterprise and National Empowerment Fund) will be rationalized by market segments. Commercial banks, widely regarded as risk averse in the SMME sector, will be expected to provide more credit in context of their Financial Sector Charter obligations. Again, the emphasis is expected to be on improved implementation.

¶12. (SBU) With the exception of investment in labor intensive sectors and financing for small business development, the private sector's role in ASGI, although assumed to be large, is unclear. It is, however, not expected to receive significant new incentives; e.g., a lower corporate tax rate, new tax deductions for investment or training, or a quicker pace in lifting the remaining exchange control regulations. While these would be positive developments, they currently are not major disincentives to investment, and Manuel is opposed to all. He also opposes tax incentives for specific sectors, industries or for specific actions, which have not proved successful in South Africa or elsewhere, but ASGI may contain such proposals if DTI views hold sway.

## Missing Ingredients

¶13. (SBU) Three key ingredients are currently missing from the proposed strategy: foreign direct investment, trade liberalization and HIV/AIDS. ASGI apparently assumes that FDI will increase as South Africa achieves a sustained increase in its growth rates and currency stability continues. Major



investments in 2005 by Barclays Bank and Vodafone lend credence to this view (ref A). Both were, however, acquisitions. Will "greenfield" investments follow? As a small, open economy -- and one that has benefited from trade reform since 1994 -- the omission of trade liberalization is hard to explain. Technical level officials at National Treasury are reportedly lobbying for its inclusion. HIV/AIDS, of course, has major workforce implications, but given the SAG's tendency to downplay the significance of HIV/AIDS, the omission is not surprising.

¶14. (SBU) Comment. With the exceptions noted above, ASGI's focus is reasonable and needed, although perhaps ambitious. The SAG can directly influence several key elements: infrastructure, skills development and service delivery. The challenge will be to bring improvements quickly. Labor market reform, however, remains the political

hot potato.  Without the cooperation of COSATU, the SACP and ANC elements such as the Youth League, progress on this issue is unlikely.  Still, successful implementation of the other ASGI initiatives could move South Africa's long term growth rate to a higher level.  TEITELBAUM